FILED
JUL 1 1942
CHARLES ELMORE CROPLEY
CLERK

No. 195

In the

Supreme Court of the United States

October Term, 1942

AMERICAN LIBERTY OIL COMPANY, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOHN BARRE KING,
Counsel for Petitioner.

E. Duncan & Co., Brief Printers, Dallas

SUBJECT INDEX

	Page
Petition for a Writ of Certiorari	1 - 7
Summary Statement of the Matter Involved	2 - 4
Issues Presented	4 - 5
Reasons for Review	5 - 6
Prayer for Writ	6 - 7
Brief in Support of Petition for a Writ of Certiorari	8 - 17
Opinions Below	8
Jurisdiction	8 - 9
Statement of Facts	9
Specifications of Error	9
Argument	10 - 16
Conclusion	17

TABLE OF CASES CITED

American Liberty Oil Company, 43 B. T. A. 76-127, Fed. (2d) 262	2, 8
Burnet vs. Logan, 283 U.S. 404	4, 10
Columbia Oil and Gas Co. vs. Commissioner, 118 Fed. (2d) 459	13
Montrose Cemetery Co. vs. Commissioner, Fed. (2d) 238	14
Ortiz Oil Co. vs. Commissioner, 37 B. T. A. 656	12
E. F. Simms vs. Commissioner, 28 B. T. A. 988	13

In the

Supreme Court of the United States

October Term, 1942

AMERICAN LIBERTY OIL COMPANY, *Petitioner*,

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, American Liberty Oil Company, respectfully represents as follows:

This is a petition for a writ of certiorari to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit, which, in all material issues involved in this petition, affirmed a decision of the United States Board of Tax Appeals, but which remanded the case to the United States Board of Tax Appeals with direction

to recompute the tax on an issue not important to this petition.

The opinion and judgment of the Circuit Court of Appeals was rendered on April 3, 1942 and is reported in 127 Fed., (2d, p. 262)

I.

Statement

The petitioner, American Liberty Oil Company, is a Delaware corporation. It owned a considerable number of leases located in what is known as the East Texas oil fields. In May, 1934 the petitioner sold these leases to the Atlantic Oil Producing Company together with all equipment situated thereon. (R. 116-162)

It reserved and accepted from the sale, however, 4,400,00 barrels of oil *when, as and if produced*, which reservation was subject to certain oil payments theretofore reserved by third parties aggregated $1,206,391.17.

The respondent, as of January 1, 1934, estimated the oil reserves in and under these leases as being 19,295,522 barrels, and at the date of the sale there was, according to the respondent, oil reserves to the amount of 19,089,603 barrels.

The facts in this case were in the main stipulated, and, according to the stipulation of facts, the petitioner received $1,500,000 in cash. At the time of the sale it had a depre-

ciated cost of well equipment of $648,134.05 and a leasehold cost less depletion allowed or allowable of $469,828.01. Petitioner also incurred legal expenses, commissions and cost of abstracts amounting to $19,149.96.

From the stipulated facts it therefore appears that the cash consideration of $1,500,000 was not equal to the depreciated and depleted cost of $1,614,122.02 and that, if petitioner was to realize a profit from this transaction, it must realize it from the 4,400,000 barrels of oil reserved *when, as, and if produced.* (See Stipulation of facts, R. 108-112 inclusive.)

Notwithstanding this fact, the respondent in his notice of deficiency determined that petitioner realized a net profit of $706,780.16 In so doing the respondent valued the oil reserved at fifty cents on the dollar and allocated both lease equipment and leasehold costs to the cash received and to the valuation he had placed on the oil reservation. (R. 112)

The Board of Tax Appeals and, in this respect, the Circuit Court of Appeals held that no part of the lease equipment cost should be allocated to the oil reservation and we have no fault to find with opinions in this particular.

Both the Board of Tax Appeals and the Circuit Court, however, held contrary to petitioner regarding what we shall call the "Tyler Pipe Line Company question." This was the only issue that was not stipulated and the facts,

as petitioner sees them, are that in order to consummate the sale to the Atlantic Oil Producing Company, the petitioner was forced to pay $120,000 to the Tyler Pipe Line Company to obtain a release from a contract it had previously made with the Tyler Company. It is true that the amount of the payment was not agreed upon and the actual payment did not occur until 1936, but when the evidence is examined, it will be seen that this payment was necessary in order to consummate the transaction. There was, in fact, no dispute as to the liability, the only dispute being as to the amount. (R. 167-169.)

Stated as succinctly as petitioner can do so, these represent the material facts and apprize the court of the issues involved.

II.

The issues presented by this petition are:

FIRST: According to the stipulated facts, petitioner received from the sale of these leases $1,500,000 in cash. It had expended in excess of $1,614,000. Its only opportunity to recoup its capital investment was from oil reservations which might or might not materialize or, as this Court said in *Burnet vs. Logan*, 283 U. S. 404, "the promise of future money payments were wholly contingent upon thing like fair certainty." Is not therefore the act of the respondent in allocating a portion of the leasehold cost to these oil reservations, which may or may not be realized, in

effect a tax imposed on capital and should not the profit be postponed until the "wholly contingent" possibility be realized?

SECOND: Bearing in mind that the reservation was so much oil and not so much money payable out of oil, can it be said that the Circuit Court of Appeals was correct in making its allocation on the basis of the market price of the oil reserved rather than an allocation on the basis that the oil reserved bore to the oil sold?

THIRD: It is not a fact that where a seller must expend a certain amount of money in order to consummate a sale, that the amount paid (whether then determined or determined at a later date) constitutes a part of its cost and doesn't it follow that where this cost is disregarded, the imposition of the tax, *without regard to the amount paid*, is a tax on capital rather than on income to the extent of such payment?

Reasons for Review

1. The decision of the Uinted States Circuit Court of Appeals for the Fifth Circuit is in direct conflict with the decision of this court in the case of *Burnet vs. Logan*, 283 U. S. 404. In the case cited this Honorable Court laid down the rule that where a taxpayer may never recoup its full cost because the future payments out of oil were "wholly contingent upon facts and circumstances not possible to fortell with anything like fair certainty," is a tax on

capital rather than upon income. This meets our case exactly because under the stipulated facts petitioner received $1,500,000 in cash and had expended in excess of $1,614,000 in cash.

2. In passing upon this case the Circuit Court of Appeals for the Fifth Circuit has decided an important question of federal law which has not been, but should be settled by this Court (if in fact a portion of the leasehold cost should be allocated to the oil reserved), then this Court should lay down a rule which would govern all other Circuit Courts of Appeals.

It is such an important question of federal law that it should be settled by this court.

WHEREFORE Your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Fifth Circuit, commanding that court to certify and to send to this court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. 10,108, American Liberty Oil Company, petitioner, vs. Commissioner of Internal Revenue, respondent, and that the judgment of the United States Circuit Court of

Appeals for the Fifth Circuit may be reversed, and that your petitioner may have such other and further relief in the premises as this Honorable Court may deem mete and just, and your petitioner will ever pray.

AMERICAN LIBERTY CIL COMPANY,

By

JOHN BARRE KING,
Counsel for Petitioner.

No. ——

In the

Supreme Court of the United States

October Term, 1942

AMERICAN LIBERTY OIL COMPANY, *Petitioner,*

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

BRIEF IN SUPPORT OF PETITION

OPINIONS BELOW

The findings and opinion of the United States Board of Tax Appeals are reported *American Liberty Oil Company vs. Commissioner*, 43 B.T.A. 76. The opinion and judgment of the Circuit Court of Appeals for the Fifth Circuit was rendered April 3, 1942 and reported in 127 Fed. (2d) 262.

JURISDICTION

The right of review of a decision of the Circuit Court of Appeals of the United States and the statutes applicable

thereto are fully set forth in rule 38 of the revised rules of this Honorable Court and no further reference need be made.

STATEMENT OF FACTS

The controlling facts are stated in the foregoing petition.

SPECIFICATIONS OF ERROR

The Board of Tax Appeals and the Circuit Court of Appeals for the Fifth Circuit has erred in the following particulars.

1. In denying the petitioner a full return of its leasehold cost in computing the gain from the sale of the leases to Atlantic Oil Producing Company.

2. In holding that any part of petitioners leasehold cost should be allocated to its right to recover 4,400,000 barrels of oil reserved *when, as and if produced.*

3. In the alternative, if any portion of the leasehold cost should be allocated to the oil reservation that such allocation should be made on a barrel basis.

4. In failing to hold that the amount paid the Tyler Pipe Line Company did not constitute a part of the cost of the sale made to the Atlantic Oil Producing Company.

ARGUMENT

Point One

The petitioner should have a full return of its leasehold cost.

After allowing the petitioner a full return of its equipment cost, both the Board and the Circuit Court of Appeals for the Fifth Circuit held that petitioners leasehold cost must be allocated between the oil interest sold and the oil interest reserved on the basis of relative values at the time of the sale.

The principle that we seek to urge is that a tax payer is always first entitled to a return of its capital investment. In this particular case the facts are that the tax-payer (petitioner) received $1,500,000 in cash, whereas, it had expended on the property sold more than $1,614,000.

Whether petitioner would ever recover its entire capital investment was based on mere conjecture because its right to receive anymore from its investment was predicated upon whether or not the 4,400,000 barrels of oil reserved would ever be produced.

We think that this Court in the case of *Burnet vs. Logan*, 283 U. S. 404 has established the correct rule of law. In that case the tax-payer sold certain stock, received a cash payment therefor, and the right to receive royalty of so much per ton on certain iron ore, which might or might not be produced. The then Commissioner of Internal Revenue

attempted to tax the taxpayer on the basis of the value of the right to receive the ore. When the case reached this Honorable Court it held "the consideration for the sale was $2,200,000 in cash and the promise of future money payments wholly contingent upon facts and circumstances not possible to foretell with anything like fair certainty * * * "She properly demanded the return of her capital investment before assessment of any taxable profit based on conjecture."

It is submitted that this decision of this Court is controlling. In our case, as in the case cited, petitioner could recoup its cost only provided the 4,400,000 barrels of oil were produced.

We therefore submit that the action of respondent in allocating a portion of the leasehold cost to the oil reservation was a tax imposed on capital rather than income.

POINT TWO

Where, especially in a case such as this (in which the oil reservation was a reservation of so many barrels of oil in place), if there should be any allocation of leasehold costs to the oil sold, such allocation should be made on a barrel basis and on the ratio that the amount of oil sold bore to the amount of oil reserved.

As the Court will notice, this reservation is an unusual one. It is not an ordinary oil payment in the sense that the

seller reserves so much oil until so much money is realized out of the oil reservation. It is a reservation of 4,400,000 barrels of oil *in place*. (R. 159).

The question then arises how much oil in place did it part with? The question is answered by referring to respondent's own estimate of the amount of recoverable oil in place. According to respondent's estimate, there were 19,089,603 barrels of oil in place when the sale was made. It follows, therefore, that the petitioner sold 14,689,603 barrels of oil in place.

Since in this case the thing retained was not so many dollars payable out of oil but so many barrels of oil in place, it seems that the only proper method of allocating leasehold cost would be on the basis of ratio as the amount of oil reserved bore to the amount of oil sold. *So many barrels of oil in place were sold. So many barrels of oil in place were reserved.*

It is true that this oil reserved would be lifted by the purchaser without cost to the seller, but this added, we submit, not one iota of value to the oil reserved *while it was in place*. It would only increase the profit of the seller when and if the oil was lifted and delivered to him.

This method of allocation was used by the Board in the case of *Ortiz Oil Co. v. Com.*, 37 B. T. A. 656, although in that case the oil reservation was a cash reservation.

It is true that the Board adopted a different method of allocation in the Columbia Oil & Gas Company case, (41

BTA 38) but in so doing, held only that the basis adopted in such case seemed an equitable allocation in that particular case and took pains to say that an equitable allocation would depend upon the facts of each particular case. It is true also that in discussing the Ortiz Oil Company case (37 BTA 656) the Board pointed out that the use of the barrels of oil method in allocating the cost basis was not in dispute. In other words the Respondent concurred.

But, in the case of *E. F. Simms vs. Com.*, 28 B. T. A. 988, where a controversy concerning a proper allocation in connection with a settlement under Rule 50 had raged for a considerable time, the Board made the allocation on a barrel basis, and its memo in connection with such hearing sustained the Respondent saying:

> "We sustain the respondent's method of computation on the right reserved to receive delivery of 400,000 barrels of oil."

It is true that in the Simms case the question was primarily one of depletion, but the method applied there is equally applicable, we submit, to a case of allocation of cost, and we desire to point out that in the Simms case as in this case the reservation was of *so many barrels of oil and not of dollars.*

The Board in the Columbia Gas Company Case (41 BTA 38) points out that respondent's regulation prescribed simply that, "the cost or other basis shall be equitably apportioned," and says that one method of allocating cost be-

tween real estate sold and real estate retained, both being parts of the same tract, is by apportioning the cost in proportion to the respective values of the part sold and the part reserved.

But such method is not always followed. In fact, in the case of *Montrose Cemetery Company v. Com.*, in a memorandum opinion and decision which was affirmed in 105 Fed. 2d 238, involving the ascertainment of the March 1, 1913 value of certain cemetery lots, the Board at great pains ascertained the value on a footage basis, and in determining profit and loss fixed a value of 23c per square foot, although a large tract was involved, and there was a variance in the value of the burial plots.

Certainly, we submit, if such a means of allocation is deemed equitable in a case such as the Montrose Cemetery Company case, a barrel basis is an equitable apportionment or allocation here. So many barrels of oil in place were sold. So many barrels of oil in place were reserved. We urge in this case that any allocation of leasehold cost be on the basis for which we contend.

POINT THREE

The amount paid as damages to the Tyler Pipe Line Company was in every sense a part of the cost of the sale made by American Liberty Oil Company to the Atlantic Oil Producing Company.

The evidence is that at the time of the sale by American Liberty Oil Company to Atlantic Oil Producing Company there was outstanding a contract between the American Liberty Oil Company and the Tyler Pipe Line Company which gave the Tyler Company the exclusive right to run all of the oil from the East Texas properties owned by American Liberty Oil Company.

The evidence is also without dispute that the Atlantic Company would not go through with the purchase of the East Texas properties of American Company unless it could obtain possession of the runs from these properties.

The evidence also is that Mr. Golding, now deceased and the owner of 45% of the stock of American Company, owned no stock in the Tyler Company. C. W. Murchison, also the owner of 45% of the stock of American Liberty Oil Company, had a substantial stock interest in the Tyler Company.

There is no evidence whatsoever which tends to show that the petitioner did not recognize when it made the sale to the Atlantic that by making such sale it was breaching its contract and would be liable at law for damages as the result of such breach or repudiation.

The record reflects the fact that there was considerable bad feeling about the transaction. Golding, who owned no interest in the Tyler Company was anxious to free the American Company of this contract as cheaply as pos-

sible. Frank Murchison, on the contrary, felt that the contract virtually gave him an equity in the property.

There is not a scintilla of evidence which reflects otherwise than that the American Liberty Oil Company at all times admitted the liability and the only dispute was as to the amount of the liability.

The Board of Tax Appeals in denying petitioner the amount paid in 1936, seems to base its opinion on an insufficiency of evidence to show that there was an admitted liability. (R. 68) The Circuit Court of Appeals in its opinion emphasized the fact that petitioner operated on an accrual basis of accounting and yet accrued nothing on its books until 1936.

It is submitted that both the Board and the Circuit Court are clearly in error. Viewed from its four corners, the record, we submit, clearly shows that *there was at all times an admitted liability* and the only dispute existing between petitioner and the Tyler Company was the amount of the liability.

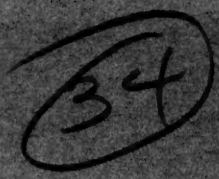
Since petitioner was on an accrual basis and since this liability had to be discharged in order for the sale to be consummated, it is our point that the deduction should have been allowed in the year 1934, the year in which the liability accrued.

CONCLUSION

It is therefore respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers and to that end a writ of certiorari should issue, and this Court should review the decision of the United States Circuit Court of Appeals for the Fifth Circuit and should reverse it.

Respectfully submitted,

JOHN BARRE KING,
Counsel for Petitioner.



Office - Supreme Court, U.
FILED
JUL 29 1942
CHARLES ELMORE CROP

No. 195

In the Supreme Court of the United States

OCTOBER TERM, 1942

AMERICAN LIBERTY OIL COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	4
Argument	7
Conclusion	10

CITATIONS

Cases:	
Burnet v. *Logan*, 283 U. S. 404	8
Columbia Oil & Gas Co. v. *Commissioner*, 118 F. (2d) 459	9
Commissioner v. *Roeser & Pendleton*, 118 F. (2d) 462, certiorari denied 314 U. S. 635	9
Palmer v. *Bender*, 287 U. S. 551	7
Thomas v. *Perkins*, 301 U. S. 655	7
Statutes:	
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 23	2
Sec. 111	2
Sec. 113	3
Sec. 114	3
Miscellaneous:	
Treasury Regulations 86:	
Art. 22 (a)–11	4

473312—42

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 195

AMERICAN LIBERTY OIL COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 62–73) is reported at 43 B. T. A. 76. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 192–195) is reported at 127 F. (2d) 262.

JURISDICTION

The judgment of the circuit court of appeals was entered April 3, 1942 (R. 196). The petition for writ of certiorari was filed July 1, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Where taxpayer sold producing leaseholds, together with the appurtenant equipment, but retained a specified interest in the oil, should the cost basis of the leaseholds be allocated between the part sold and the part reserved, in proportion to the respective values of the interest sold and the interest retained?

2. In 1934 the taxpayer committed a breach of a contract to supply oil, and in 1936 agreed to pay and paid the other party to the contract $120,000 in settlement of that party's claim. May the taxpayer take a deduction from its 1934 income on account of the payment made in 1936?

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.* — All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *
>
> * * * * * *
>
> SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.
>
> (a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the

adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

* * * * *

(3) *Percentage depletion for oil and gas wells.*—In the case of oil and gas wells the allowance for depletion under section 23 (m) shall be 27½ per centum of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under

section 23 (m) be less than it would be if computed without reference to this paragraph.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)–11. *Sale of real property in lots.*—If a tract of land is purchased with a view to dividing it into lots or parcels of ground to be sold as such, the cost or other basis shall be equitably apportioned to the several lots or parcels and made a matter of record on the books of the taxpayer, to the end that any gain derived from the sale of any such lots or parcels which constitutes taxable income may be returned as income for the year in which the sale is made. This rule contemplates that there will be gain or loss on every lot or parcel sold, and not that the capital in the entire tract may be recovered before any taxable income shall be returned. The sale of each lot or parcel will be treated as a separate transaction, and gain or loss computed accordingly.

STATEMENT

The pertinent facts, as found by the Board of Tax Appeals, may be summarized as follows:

Facts with respect to the allocation of the cost of the leases.

On January 1, 1934, taxpayer owned certain leasehold interests in oil and gas producing properties and the lease and well equipment thereon. Its interests in the oil reserves, as estimated by the

Commissioner, amounted to 19,295,522 barrels as of that date. Between that date and April 18, 1934, 205,919 barrels were extracted so that an estimated 19,089,603 barrels remained. (R. 60, 110.)

On April 18, 1934, taxpayer sold these leasehold interests together with the equipment for a cash price of $1,500,000. It excepted from the sale, however, 4,400,000 barrels of oil when, as, and if produced, less certain amounts to be paid to third parties in accordance with contracts previously made by the taxpayer. (R. 60, 116–161.) The fair market value of this reserved oil interest was not less than $1,596,804.41 (R. 60, 110).

The cost of the leaseholds, less depreciation allowed or allowable as of the date of the sale, was $946,828.01. The depreciated cost of the equipment was $648,134.05. The costs incurred by taxpayer in connection with the sale for legal expenses, commissions and abstracts of title amounted to $19,149.96. (R. 60–61, 111.)

The Board of Tax Appeals and the court below held that the profit which taxpayer realized from the sale should be determined in two steps: first, the cost basis for the leaseholds should be allocated between the oil interests sold and the oil interest reserved in proportion to the respective values of such interests at the date of sale; second, from the cash consideration (which was paid for the oil interest sold plus the equipment) there should be deducted the sum of (a) the portion of the total

cost allocated to the oil interest sold, (b) the expenses of the sale, and (c) the depreciated cost of the equipment.[1]

Facts with respect to taxpayer's breach of contract in 1934 and settlement for $120,000 in 1936.

The foregoing sale of taxpayer's properties disabled it from performing a written but unrecorded contract (Ex. 2, R. 177–179) to sell and deliver to the pipe lines of the Tyler Pipe Line Company such amounts of oil produced from the taxpayer's so-called Golding–Murchison properties as the Tyler Company might desire to purchase (R. 62). Negotiations with the Tyler Company to determine the extent of taxpayer's liability on account of

---

[1] The following is a computation of the taxpayer's income in 1934 from the sale, made in accordance with the findings and opinion of the Board (cf. R. 79–80):

Fair market value of all properties at date of sale:		
Cash	$1,500,000.00	
Value of oil payment reserved (stipulated)	1,596,804.41	
		$3,096,804.41
Less: equipment		648,134.05
Value of all oil rights		2,448,670.36
Value of oil rights sold:		
Cash selling price	$1,500,000.00	
Less: cost of equipment	648,134.05	
		851,865.95
Value of oil rights retained (i. e., 4,400,000 barrels less payments to third persons)		1,596,804.41
Cost of leasehold interest sold: $\frac{\$851,865.95}{\$2,448,670.36} \times \$946,828.01 =$		329,391.05
		617,436.96)
(Cost of oil rights retained		
Cash received on sale		1,500,000.00
Less:		
Cost of leasehold interest sold	$329,391.05	
Equipment	648,134.05	
Expense of sale	19,149.96	
		996,675.06
Correct profit on sale		$503,324.94

the breach of the contract had commenced even prior to the sale and they continued until April 1, 1936 (R. 63). On that date the Tyler Company discharged taxpayer from its obligation under the contract for a consideration of $120,000 (see release, Ex. 3, R. 179–182). On June 30, 1936, the amount of the payment was entered on the books of taxpayer in an account entitled "Sale of Leases—Atlantic" (see R. 182–A). On December 31, 1936, the item was transferred to an account styled "Earned Surplus—Unappropriated 1934" (R. 63, 185).

The court below affirmed the decision of the Board of Tax Appeals holding that the $120,000 payment was not deductible from taxpayer's gross income for the year 1934 (R. 60–65, 194–195).

ARGUMENT

1. The taxpayer sold a part of its interest in oil properties and retained a part. As to the reserved interest in the oil, taxpayer will be entitled to depletion deductions as and when such oil is produced. *Palmer* v. *Bender,* 287 U. S. 551; *Thomas* v. *Perkins,* 301 U. S. 655. Accordingly, it would secure a double deduction for the same capital investment if it prevailed in its present attempt to deduct the entire cost of the leaseholds from the price received for the part sold. The court below properly concluded (R. 194) that the cost of the leaseholds must be allocated between the part sold and the part retained in proportion to the respective values of each.

It was also correct to allocate the total cost in the proportion which the value of the interest sold bore to the value of the interest retained. The taxpayer's contention that the allocation should be made in the proportion of the estimated number of barrels sold to the number of barrels retained, disregards two essential facts. The first is that the reserved interest was to be drawn from a substantial proportion of the first oil produced (R. 118–119) so that the value of each of the barrels reserved was far greater than the more speculative value of the last of the barrels which the field was estimated to contain. Second, the reserved interest was to bear none of the costs of operation, another factor giving it a greater value than the comparative volumes alone would indicate.

Taxpayer alleges as the principal reason for granting the writ that the decision below conflicts with *Burnet* v. *Logan,* 283 U. S. 404, on the question of whether any apportionment should be made (Pet. 5). There is no conflict. In *Burnet* v. *Logan,* it appeared that the taxpayer in 1916 had sold all of certain stock for a cash consideration plus a promise to make future payments for each ton of ore received from a certain mine. The Commissioner, treating the capital transaction as closed in 1916, valued the contingent promise, and sought to allocate a pro rata portion of the cost basis to each of the recurrent payments, treating the excess as income, though the cash consideration, plus the sum of the actual payments, was less than the cost basis of the stock. The Court pointed

out that the taxpayer did not realize either a return of capital or income upon mere receipt of the contingent promise, and held that no part of the future payments was taxable as income until the sum of the payments received exceeded the basis of the stock. But in the present case, no effort was made to tax the taxpayer as if it had received contingent future payments. In the present case the taxpayer retained a part interest in the property and the sole question is whether there should be an allocation of the cost basis of the property between the part retained and the part sold, so as to determine fairly the gain on the part sold. It is true that the allocation requires a valuation of the right to 4,400,000 barrels of oil when, as, and if produced. But this is in no way contrary to *Burnet* v. *Logan*. In that case the Court pointed out that the contingent promise could be valued where necessary, as, for example, for purposes of the federal estate tax. So here it is proper to value the oil interest retained, even though contingent, in order to determine the taxpayer's gain upon the closed sale of the other part of the property.

The court below followed its decisions in *Columbia Oil & Gas Co.* v. *Commissioner*, 118 F. (2d) 459, and *Commissioner* v. *Roeser & Pendleton*, 118 F. (2d) 462.[2] There is no authority to the contrary.

[2] In the latter case a petition for certiorari raising other questions was denied, 314 U. S. 635.

2. The second question presented depends upon the application of settled principles of accounting to disputed facts. Under Point 3 of its brief (Br. 14–16) the taxpayer, which was on the accrual basis, asserts that the evidence clearly showed an admission of liability for breach of contract in 1934, and upon that basis argues that since the only uncertainty was with respect to the amount of the settlement to be made, the deduction should have been allowed in 1934. The Board determined, however (R. 63), that the proof did not establish that in 1934 taxpayer admitted to any liability beyond that for a technical breach of contract. Thus, the taxpayer is seeking to present an issue arising only upon a view of the facts with which both the Board and the court below have disagreed. The issue presents no basis for the issuance of the writ.

CONCLUSION

The decision below is correct. There is no conflict of authorities. The petition should be denied.

Respectfully submitted,

OSCAR COX,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
HELEN R. CARLOSS,
JOSEPH M. JONES,
Special Assistants to the Attorney General.
ARCHIBALD COX,
Attorney.

JULY, 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942